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Article 1

A New Trade Strategy: The Case for Bilateral Agreements

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A New Trade Strategy: The Case For Bilateral Agreements

A rare window of political and economic opportunity opened last January when the United States and Canada concluded a major bilateral trade accord: the U.S.-Canada Free Trade Agreement ("FTA").[1] Although not perfect, the FTA represents an important step forward in an era during which retreat has been the rule. The FTA helps dispel some of the myths surrounding United States trade policy. It proves to skeptics both here and abroad that the United States can make progress in the trade realm. Even under difficult economic conditions, the United States still can conclude trade agreements with its major trading partners. More importantly, the FTA debunks the conventional wisdom by demonstrating that successful trade agreements can be negotiated bilaterally as well as multilaterally.

The new President finds himself at a crucial juncture. Should he follow the example of the FTA and aggressively seek new bilateral trade agreements or should he continue to focus on multilateral accords? The new President has a unique opportunity to harness the political momentum created by the FTA. If he acts early and decisively, the President can conclude bilateral and multilateral agreements that advance the United States' economic interests. If he falls into the trap of excessive reliance on multilateralism, he may squander this opportunity.

This Article argues that future United States trade policy should focus more on bilateralism. First, it examines current United States trade problems, giving particular consideration to the predominant influence of multilateralism. Second, the Article outlines the advantages of a bilateral trade strategy. It evaluates specific candidates for future bilateral agreements, with a special focus on a U.S.-Japanese accord.

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1. United States-Canada Free Trade Agreement Communication from the President, H.R. Doc. No. 216, 100th Cong., 2d Sess. (1988).

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Finally, the Article outlines a strategy for the new President, demonstrating the compatibility of bilateral and multilateral agreements. Far from undermining multilateral institutions, bilaterals may offer a tool for reinvigorating the multilateral process.

I. America's Trade Problems

A. Trade and the U.S. Economy

Since World War II, trade has become increasingly important to the United States economy. The trade components of the nation's gross national product increased between 200 and 400 percent since 1950.[2] Today, almost 20% of the U.S. economy is linked directly to trade; fully 70% of the products America produces compete with imports.[3]

The expanding role of international trade has recently proved a mixed blessing to the United States. In the last eight years, the United States has experienced an international economic disaster. From 1980 to 1987, the nation's trade deficit swelled from $31 billion to $170 billion.[4] Over the same period, the manufacturing trade balance tumbled from a $27 billion surplus to a $138 billion deficit.[5] Individually, virtually every manufacturing industry had a lower trade balance in 1987 than in 1980.[6] The trade deficit is now larger than the GNP of all but 20 nations.[7] In human terms, the $170 billion trade deficit means that between two and four million Americans have lost their jobs over the last seven years.[8]

In order to finance this growing deficit, the United States has borrowed dollars from foreign creditors. Last year alone, the nation borrowed $100 billion from the rest of the world.[9] By the end of 1987, the United States owed foreign creditors $400 billion—more than the combined debt of all the third world debtor nations.[10] By the mid 1990s, the total U.S. foreign debt could approach $1 trillion.[11] In seven short years, the United States has gone from being the world's largest creditor nation to being the world's largest debtor nation.[12]

2. *See* Thurow & Tyson, *The Economic Black Hole*, 67 FOREIGN POL'Y 1-4 (1987); Choate & Lynger, *Tailored Trade: Dealing with the World As It Is*, HARV. BUS. REV. 86-88 (Jan./Feb. 1988).

3. *See* NATIONAL ASSOCIATION OF MANUFACTURERS, COMPETING IN THE GLOBAL ECONOMY 1 (1987). OFFICE OF TECHNOLOGY ASSESSMENT, *Paying the Bill: Manufacturers and the U.S. Trade Deficit*, OTA ITE-390, at 1-8 (June, 1988) [hereinafter OTA].

4. OTA, *supra* note 3, at 9-16.

5. U.S. CONGRESS, 1988 JOINT ECONOMIC REPORT 16 (1988).

6. *Id.*

7. Thurow & Tyson, *supra* note 2, at 3-4.

8. *See id.* (If the U.S. had achieved a balanced trade position in 1986 it would have employed approximately 4 million additional workers.)

9. OTA, *supra* note 3, at 1.

10. *Id.* at 1-4.

11. *Id.*

12. *Id.*

Like all loans, the loans that the United States has used to finance its imports must be repaid with interest. The annual interest payment on the debt in the 1990s is likely to approach $100 billion.[13] Each $40 billion in interest payments converts to about a 1% drop in the U.S. standard of living.[14] By the 1990s, interest payments could force the American standard of living down by two to three percent—a very serious recession equivalent to that suffered during the Great Depression.[15] As the Office of Technology Assessment recently noted: "No nation, not even one as rich as the United States, can go on forever paying for its current account deficit with foreign capital. A time of reckoning will come."[16]

Even these dire macroeconomic figures do not fully illuminate the problems that the United States has experienced in critical economic sectors. The United States has lost its pre-eminence in such critical manufacturing industries as semiconductor and consumer electronic product manufacturing. In 1980, for example, the United States held 75% of the world semiconductor market. Japan held only about 25%. By 1987, a dramatic reversal had occurred as the U.S. held only 25% of the world semiconductor market while Japan held nearly 75%.[17] The problem has continued to spread. The United States is now being challenged in other areas that it previously dominated, such as the design and manufacture of supercomputers.[18]

B. Flawed U.S. Trade Strategy

No single element independently explains the rapid deterioration of the U.S. trade position. An overvalued dollar, uneven world growth, and unfair foreign trade practices all have contributed to the trade deficit. The single largest reason why the United States has not been able to deal with these problems is because the nation has fallen into the trap of using yesterday's solutions to solve today's problems.

1. Reliance on Multilateralism

Nowhere is this problem more apparent than in our strategy toward international trade negotiations. Since World War II, the United States primarily has relied upon negotiations under the auspices of the General Agreement on Trade and Tariffs ("GATT")[19] to achieve its trade objectives. Through the GATT, the United States has pressed fellow mem-

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13. *See* Thurow & Tyson, *supra* note 2, at 5.
14. *Id.* (assuming a trade imbalance of $20 billion annually).
15. *Id.*
16. OTA, *supra* note 3, at 1.
17. C. PRESTOWITZ, TRADING PLACES: HOW WE ALLOWED JAPAN TO TAKE THE LEAD 45 (1988).
18. *See* Leopold, *Japanese Target U.S. Superfast Computers*, Def. News, Aug. 29, 1988, at 1, col. 1.
19. 61 Stat. (5), (6), T.I.A.S. No. 1700, 55 U.N.T.S. 194. For the current version binding on the United States, see 4 BASIC INSTRUMENTS AND SELECTED DOCUMENTS 1 (1969) [hereinafter GATT].

bers to agree upon trading rules that provide for the conduct of international trade on a more or less free market basis.[20]

The United States trade policy establishment has committed itself firmly to the GATT. The conventional wisdom is that bilateral agreements are, except in rare cases, at best ineffective, and at worst a serious threat to GATT members' commitment to the multilateral process.[21] This attitude is a large part of the trade problem.

2. Evaluating the GATT

The GATT served the United States during the period immediately following World War II. Following its creation in 1948, the GATT reduced worldwide tariff levels and expanded world trade.[22] The United States continues to emphasize the GATT today. The theoretical attractiveness of multilateral agreements over bilateral agreements is easy to grasp: the benefits of a multilateral agreement generally are larger than the benefits of a bilateral agreement because a multilateral agreement opens many markets while a bilateral agreement opens only one.[23]

For the last fifteen years, the GATT has been stumbling. As some nations have lowered their tariffs, other nations have raised non-tariff barriers, such as export subsidies and variable levies.[24] The GATT has not successfully addressed these non-tariff barriers. As progress in the GATT has slowed to a crawl, the organization has lost credibility as the policeman of world trade.

The failings of the GATT can be traced to its origins. The GATT was created as an interim measure pending the creation of a real international organization to police world trade. Unfortunately, the "real" international organization never came into existence, and the interim measure became permanent. The GATT successfully lowered worldwide tariff levels.[25] Unfortunately, it is an insufficient tool for regulating today's more complicated international commerce.

The limited nature of the GATT underscores the need for alternate trade policy tools. The GATT covers only about 7% of world commerce.[26] Major economic powers, such as the Soviet Union and China, are not GATT members. Both of these nations have non-market economies that are fundamentally incompatible with the GATT's current structure. Unless these nations restructure their economies or the

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20. J. Baker, *The Geopolitical Implications of the U.S.-Canada Trade Pact*, INT'L ECON. 35, 36 (Jan./Feb., 1988). *See also* Choate & Lynger, *supra* note 2, at 86-88.

For a comprehensive history of the debate regarding the relative merits of bilateralism and multilateralism, see Diebold, *The History and Issues* in BILATERALISM AND MULTILATERALISM AND CANADA IN U.S. TRADE POLICY 1-32 (Diebold ed. 1988).

21. Choate & Lynger, *supra* note 2, at 86-88.
22. D. BONKER, AMERICA'S TRADE CRISIS 188-207 (1988).
23. Diebold, *supra* note 20, at 172-81.
24. Baker, *supra* note 20, at 38.
25. Choate & Lynger, *supra* note 2, at 88.
26. *Id.*

GATT members change the agreement, it is unlikely that non-market economies will be accommodated.[27] Furthermore, the GATT does not address capital flows, international investment, protection of intellectual property, trade in services, exchange rates, and a myriad of other issues related to international commerce.[28] Certain practices that clearly restrict trade, such as Voluntary Restraint Agreements ("VRAs") and variable levies, escape challenge under the GATT.[29] Finally, the GATT effectively excludes such large sectors of the merchandise trade as textiles and agricultural products.[30]

Even in the small sector of international commerce where it clearly applies, the GATT has proven an ineffective policeman. In order to convince nations to join the GATT, draftsmen have built a number of dispute settlement safeguards into the process to ease fears about yielding sovereignty to an international body. Once a trade practice is challenged under the GATT, consultations ensue between the parties. If, as is usually the case, the consultations do not resolve the issue, a dispute settlement panel must be formed to consider it. The nation challenged under GATT can drag out the process of forming a panel. Even if an aggrieved party obtains a panel ruling, any party to the GATT can block acceptance of the ruling. Using these and other procedural safeguards, a major power easily can derail the GATT dispute settlement procedures.[31] Beyond that, even after the GATT has ruled, many nations have for years refused to act.[32]

GATT dispute settlement procedures often take years, leading frustrated negotiators to dub the agreement "the Gentlemen's Agreement to Talk and Talk." A 1987 General Accounting Office study of GATT dispute settlement procedures reported that the average United States complaint to the GATT took 45 months to resolve.[33] The infamous citrus dispute between the United States and the European Community dragged on for 12 years.[34] Understandably, many nations prefer to resolve trade disputes bilaterally rather than involve the GATT.

Unless something radically changes the international environment, little progress through the GATT is likely in the foreseeable future. Since its inception, the GATT membership has grown from 23 to 94

27. *Id.* at 87-90.

28. *Id.* at 88.

29. Baker, *supra* note 20, at 38.

30. *See* Choate and Lynger, *supra* note 2, at 88.

31. For a thorough description of the GATT dispute settlement procedures, see THE U.S. INTERNATIONAL TRADE COMMISSION, REVIEW OF THE EFFECTIVENESS OF TRADE DISPUTE SETTLEMENT UNDER THE GATT AND TOKYO ROUND AGREEMENTS, USITC PUBLICATION 1793 (Dec. 1985).

32. Choate & Lynger, *supra* note 2, at 88.

33. GAO REPORT, GAO PUBLICATION No. N.SIAD-87-100 (March, 1987). On perceived problems in the GATT dispute settlement procedures, see THE U.S. INTERNATIONAL TRADE COMMISSION, The Multifiber Arrangement, 1980-84, USITC Publication 1693 1-4 (May 1985).

34. Choate & Lynger, *supra* note 2, at 88.

nations.[35] In theory, expanded membership initially may be viewed as positive because the potential exists for eliminating more trade barriers. In practice, expanded membership has meant that progress in the GATT has slowed to a crawl. Each new nation has its own agenda and particular areas in which it will resist GATT discipline. As more nations have joined the GATT, the barriers to progress have grown proportionally. The first few rounds of GATT negotiations took less than a year each. The latest round—the Tokyo round—lasted six years.[36]

3. *Uruguay Round Prospects*

Many hope that the GATT's problems could be addressed in the current Uruguay Round of GATT negotiations. The United States has unveiled an aggressive GATT agenda that includes expanding the GATT to cover services, agriculture, investment, and intellectual property, as well as streamlining dispute settlement.[37] Despite this initiative, other nations appear ready to block efforts to further liberalize international trade. The European Community ("EC")—an advocate of the GATT in the past—now seems more interested in internal market liberalization through the "Europe 1992"[38] talks and is less concerned with multilateral market opening through the GATT. The EC also is unwilling to impose significant discipline on agricultural trade.[39] Although it may have more to gain from a successful GATT round than any other nation, Japan has never been an enthusiastic participant in GATT negotiations. Some of the newly industrialized countries ("NICs"), such as Korea, would rather pursue mercantilist policies on the Japanese model than submit to GATT restrictions. Finally, a number of the developing nations, Brazil and India in particular, would prefer to avoid further GATT discipline, especially protection of intellectual property and trade in services.[40]

Only the United States and a few of its closest allies appeared truly committed to progress through the Uruguay Round. Even within the United States, there are reasons to doubt the existence of the domestic consensus necessary to win approval of the current GATT agenda, especially in the area of agricultural products.[41]

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35. *Id.* at 86.
36. *Id.* at 88.
37. D. BONKER, *supra* note 22, at 202.
38. "Europe 1992" is used to describe the new EC initiative to create a true common market and turn Europe into an economic superpower. For a good history, see Yemma, *Setting Sights Boldly on Unity*, Christian Sci. Monitor, June 27, 1988, at 1, col. 1. This article is the first in a four-part series discussing Europe 1992. Part Four was published on June 30, 1988, and discussed the U.S.-Japanese reaction to the EC initiative. *See U.S. and Japan Size Up New Kid on the Block*, Christian Sci. Monitor, June 30, 1988, at 1, col. 1.
39. D. BONKER, *supra* note 22, at 202. *See also* UNITED STATES TRADE REPRESENTATIVE, URUGUAY ROUND UPDATE 4 (Sept. 1988) (copy on file at the office of the *Cornell International Law Journal*).
40. *See* UNITED STATES TRADE REPRESENTATIVE, *supra* note 39, at 8.
41. *See id.* at 4.

The fundamental problem is that the United States no longer has the unquestioned economic and political dominance required to force the rest of the world to play by its rules. Commitment by the United States may have been enough to move the GATT after World War II, but the United States no longer has the necessary power. Intransigence on the part of even one major trading partner can cripple the GATT negotiations.[42]

American attempts to wield influence are further complicated by the fact that other major trading nations (especially Japan, Korea, and the larger developing nations) do not share the United States' commitment to the market principles enshrined in the GATT. Export driven economies on the Japanese and Korean model simply are not market economies in the sense that the United States has used the term. In fact, there are relatively few true market economies in the world.[43] Nations with different economic systems are increasingly unwilling to have American free market principles imposed upon them through the GATT.

II. The Bilateral Alternatives

A. Escaping the GATT Mindset

Despite the signs of failure all around, many in the trade establishment are unwilling to look for alternatives to the multilateral approach. In fact, new approaches like the FTA almost invariably have been criticized as undermining the GATT process. As Pat Choate of TRW, Inc. recently wrote:

> While multilateral talks drag on, the United States misses opportunities for international economic cooperation and trade expansion. The new reality is that a multilateral world requires more options, both inside and outside the GATT, than multilateral negotiations provide. . . . Indeed, the GATT's inability to change has made the agreement not merely an obstacle, but a threat to expanded world trade.[44]

The United States should not abandon the GATT. There are still issues that the GATT can address effectively. The United States cannot expect much progress, however, unless it gives other nations an incentive to negotiate. Certainly, we no longer can afford to rely on the GATT as heavily as we have since World War II. Times have changed; the U.S. must forge a new strategy.

B. Advantages of Bilateral Agreements

While multilateral agreements theoretically may be preferable to bilateral agreements, bilateral agreements have several practical advantages. First, the old rule of thumb that "the fewer parties at the table the faster

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42. At the recent Toronto Economic Summit, America's allies rebuffed several American initiatives. *See generally* Kilborn, *U.S. to Give Poor Lands More Time to Pay Debts*, N.Y. Times, June 21, 1988, at A8, col. 1.

43. Choate & Lynger, *supra* note 2, at 86-93.

44. *Id.* at 86.

the negotiations" is particularly applicable in international trade negotiations. As the FTA negotiations demonstrate, significant progress can be made in a relatively short time. The Canada FTA negotiations took about 16 months while the last GATT round took six years.[45]

Second, bilateral agreements provide a more flexible forum for addressing economic problems. As the current GATT round demonstrates, developing and developed nations have very different economic problems and interests. For example, many of the developing nations have been unwilling even to discuss further protection of intellectual property. As the FTA demonstrates, however, a bilateral forum allows the parties to address broader issues that are very difficult to address in the multilateral GATT negotiations. Trade in services and investment are examples of such problems. The United States can use bilateral agreements to address a myriad of problems ranging from exchange rate fluctuation to inadequate distribution systems that probably are beyond the current scope of the GATT.

Perhaps the major advantage of bilateral agreements is that success is possible. Bilateral negotiations give the United States an option of avoiding the multilateral deadlock. Nations that are unwilling to negotiate will no longer frustrate American objectives. With bilateral negotiation as a viable alternative, the United States can sidestep States that refuse to negotiate seriously in the GATT.

C. Japan as a Bilateral Target

Besides Canada, other major trading partners present opportunities for new bilateral agreements. Japan is a particularly attractive target.

1. Japan as an Economic Superpower

Economic realities bolster the case for a bilateral trade and economic agreement with Japan. The United States and Japan are the two largest economies in the free world.[46] They have the largest bilateral trade relationship between major countries.[47] America is Japan's largest trading partner, and Japan is the United States' second largest trading partner (after Canada).[48] Japan is the largest source of foreign investment in the U.S., and Japan is the United States' largest creditor.[49]

Japan has joined the United States as the world's second financial superpower. Tokyo and New York are the world's two largest financial centers. Increasingly, Tokyo is the place that the world goes for capi-

45. Baker, *supra* note 20, at 41; C. AHO & A. ARONSON, TRADE TALKS: AMERICA BETTER LISTEN! 19 (1985).

46. *See* Morse, *Japan's Drive to Pre-eminence*, 69 FOREIGN POL'Y 3 (Winter 1987-88).

47. *Id. See also* Bergsten, *Economic Imbalances*, 65 FOREIGN AFF. 770, 789-90 (1987) ($115 billion annually).

48. *See* U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 791 (1985).

49. OTA, *supra* note 3, at 9-11.

tal.[50] The dollar and the yen are the world's two largest currencies. The yen's value has risen remarkably. In 1980, 66.5% of international bond issues were denominated in U.S. dollars, 17.5% in Deutsche marks, and only 1.5% in yen. By 1987, there had been a dramatic shift: 35.8% were in U.S. dollars, 8.1% in Deutsche marks, and 14.1% in yen.[51]

2. Japanese Trade Barriers

Japan plays an important role in the United States' international economic problems. The problems are most apparent on the trade front. Between 1980 and 1986, United States-Japan trade had grown from $54 billion to $115 billion.[52] Of the $61 billion increase, rising Japanese exports to the United States had accounted for $53 billion.[53] Increased United States exports to Japan had accounted for only about $8 billion.[54] More than one third of the $60 billion United States trade deficit is with Japan. The American bilateral deficit with Japan is more than three times as large as the bilateral deficit with any other nation.[55] Perhaps most troubling is the persistence of the trade imbalance with the United States. Despite wide fluctuations in exchange rates and other economic factors, the United States has run a trade deficit with Japan for more than 20 years.[56]

A recent World Bank study indicated that Japan maintains the most heavily protected market of any nation in the developed world, with nearly twice as many barriers as the United States.[57] The ratio of manufactured imports to GNP for Japan has remained close to 2% for the last 20 years; in other industrialized nations that ratio is higher and continues to rise.[58]

The most important barriers in the Japanese marketplace are largely cultural. The network of personal ties between Japanese businesses together with the Japanese distribution system have combined to create formidable barriers to the Japanese market. As American soft drink exporters have found, a superior product at a lower price is not always enough to penetrate the Japanese business network. Personal relationships between Japanese businessmen create a strong preference to "buy Japanese," a significant barrier to United States exporters with designs on the Japanese market. Because it is merely a matter of Japa-

50. *See* Kido, *International Use of the Yen Seen Increasing Steadily,* Japan Econ. J., May 14, 1988, at 1, col. 5.

51. *Id.*

52. Morse, *supra* note 46, at 20.

53. *Id.*

54. *Id.*

55. OTA, *supra* note 3, at 3.

56. Stokes, *Living With a New Japan,* 11 NAT'L J. 657-61 (1988).

57. WORLD BANK, 1987 WORLD DEVELOPMENT REPORT, BARRIERS TO ADJUSTMENT AND GROWTH, IN THE WORLD ECONOMY, INDUSTRIALIZATION AND FOREIGN TRADE, WORLD DEVELOPMENT INDICATORS 142 (1987).

58. THE ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, JAPAN, OECD ECONOMIC SURVEYS 40 (1985).

nese businessmen preferring to buy from other Japanese businessmen, not a government policy, this problem is difficult to address either through the GATT or American trade law.[59]

In addition to the "buy Japanese" bias, the multi-layer Japanese distribution system of small middlemen and retail outlets also has served as a barrier between the exporter and the Japanese consumer.[60] Even if exporters successfully penetrate the distribution system, the price of their products may rise as much as 300% as they pass through the distribution layers to the Japanese consumers.[61]

Some argue that Japan is always likely to run a trade surplus with industrialized nations because it must export manufactured goods on a massive scale in order to pay for the imported energy and raw materials that it cannot produce domestically. Although Japan is dependent upon foreign sources for energy, food and raw materials, the Japanese trade surplus with developed nations has offset this dramatically. Last year the Japanese trade surplus with the world was $80 billion.[62] It has grown so large that the Organization for Economic Co-operation and Development recently urged Japan to reduce the surplus because it threatened the world economy.[63]

3. Other Economic Problems

Japan's closed market also has affected lesser developed countries ("LDCs"). Over the last decade, the United States has absorbed more than 60% of LDC exports. Japan has taken only about 5%. The closed Japanese markets have deprived LDCs of needed export opportunities.[64]

The problems do not end on the trade front. The dollar and the yen have been on a tremendous roller-coaster ride. In 1980, the yen/dollar exchange rate stood at 200:1. In February 1985, the exchange rate had peaked at 262:1.[65] By February of 1988, the dollar had plunged to approximately 125 yen to the dollar—a 55% depreciation.[66] When exchange rates fluctuate, the price of exports and imports also fluctuate. If the dollar appreciates 50%, the price of American exports increases by 50%. Wild swings in the yen/dollar exchange rate

59. *See* Fallows, *Japan: Playing by Different Rules*, ATLANTIC MONTHLY 22, 24-28 (Sept. 1987).

60. *Id.*

61. *Id.* at 26-27. *See* Gephardt, *Trade: The Establishment's Game*, Wash. Post, Jan. 25, 1988, at A19.

62. United Nations, Department of International Economic and Social Affairs, *Monthly Bulletin of Statistics*, Nov. 1988, at 96.

63. New OECD Study released Aug. 28, 1988. Complete citation not yet available.

64. Robinson, *For A Japanese Equivalent of the Marshall Plan*, N.Y. Times, May 3, 1986, § 1, at 27.

65. Gilpin, *The Dollar's Wild Ride*, N.Y. Times, June 19, 1988, § 3, at 7.

66. *Another Low for Dollar*, N.Y. Times, Jan. 4, 1988, at D3, col. 6. In Tokyo, the dollar opened trading against the yen on Jan. 4, 1988 at 120.45:1.

have exacerbated trade imbalances and devastated export industries in both countries.

The world's two economic superpowers have failed to coordinate economic policies. In the mid-1980s, the United States had pursued an expansionary economic policy founded on a tax cut and deficit spending. At the same time Japan took the opposite economic tack. Failure to coordinate greatly inflated the trade imbalance. As the overstimulated United States economy had drawn in imports and had borrowed the dollars from Japan to pay for them, both the trade imbalance and United States debtor status ballooned.[67]

Other underlying differences between American and Japanese economic habits militate against expanding trade. Japanese consumer spending has lagged behind that of similarly situated developed economies because of Japan's high savings rate and very high food and housing costs.[68] The average Japanese consumer lives in a house about one-half the size of his American counterpart and spends three times as much on food.[69] If Japan could ease the combined burden of saving, food, and housing, a tremendous burst of consumer demand could be released. This new domestic demand could cut the Japanese trade surplus by increasing imports and absorbing a larger share of Japanese production.

4. *Disproportionate Defense Spending*

Beyond these purely economic problems is the issue of burden sharing. Though both nations obviously benefit from western security spending, the financial burden continues to fall disproportionately on the United States. The United States currently spends about seven percent of its GNP on security while Japan spends only about one percent.[70] There is a growing consensus within the United States that the disproportionate burden of defense spending on the American economy has hindered the nation's competitiveness in international markets. Simply put, the dollars spent on defense have contributed to United States macroeconomic ills and cannot be reinvested in the economy.

Japan has attempted to ease this imbalance by increasing its contribution to American forces stationed in Japan, committing resources to keeping the Persian Gulf open, and increasing foreign assistance. The combined impact of these steps on the overall balance of security spending nevertheless is minimal.[71] The U.S. and Japan must consider important foreign policy questions before Japan can take further steps toward

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67. *Forget the Growl, Look at the Tails*, ECONOMIST at 18 (Jan. 9, 1988). A. ROMBERG, U.S.-JAPAN RELATIONS: A PARTNERSHIP IN SEARCH OF DEFINITION 10 (1988).

68. Fallows, *supra* note 59, at 26-27. ECONOMIST, *supra* note 67, at 18.

69. *See* Bergsten, *supra* note 47, at 782; Fallows, *supra* note 59, at 26-27; Packard, *The Coming U.S.-Japan Crisis*, 66 FOREIGN AFF. 348, 359 (Winter, 1987-88).

70. Hepstone, *A Barrier Finally Crossed in Japan*, Wash. Times, Jan. 17, 1987, at 3E.

71. *See Japan's Foreign Aid Policy: 1987 Update*, 41 A JAPAN ECONOMIC INSTITUTE REPORT 1 (Oct. 30, 1987).

assuming its share of the defense burden. If the United States and Japan are to compete on equal footing, however, they must address this problem.

5. *Failure of the Current Ad Hoc Approach*

In the face of a battery of significant problems, the United States and Japan have yet to devise a coherent strategy to address their mutual economic concerns. The Reagan Administration attempted to address most of its problems with Japan—including the trade imbalance, the value of the yen, and Japanese security spending—through ad hoc, bilateral negotiations. This strategy has three serious flaws. First, it is poorly focused. Considerable time and political capital is spent on issues of little economic import.[72] Second, the ad hoc, issue by issue approach creates the impression in Japan that the United States is a perpetual complainer. Public opinion in Japan has swung against the United States.[73] This loss of goodwill substantially decreases American leverage with Japan on the larger, underlying issues.

Finally, the United States has failed to establish a central agenda for its negotiations with Japan. Each agency negotiates with Japan on its own, with little central control. George Packard, Dean of the School of Advanced International Studies at Johns Hopkins University, explained the Japanese response to the ad hoc approach of the United States: "Japanese negotiators have learned to wait patiently until today's issue gives way to tomorrow's. They cannot be blamed for failing to understand or act upon American priorities, for no one can say at any moment what these priorities are."[74]

In short, the bilateral economic problems have grown too large for multilateral negotiations. The current approach of ad hoc bilateral negotiations to address United States concerns has failed. The time has come for a more ambitious, better conceived trade policy.[75]

D. A U.S.-Japan Economic Accord

The time is ripe for a major bilateral accord between the United States and Japan. This agreement should address three major issues: the

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72. 134 CONG. REC. S1082 (daily ed. Aug. 5, 1988) (statement of Sen. Baucus). I first discussed this concept in a speech to the Tokyo Press Club in March, 1988.

73. *See* Haberman, *Japanese Favor a Global Role A Survey Finds*, N.Y. Times, May 3, 1988, at 1, col. 1.

74. Packard, *supra* note 69, at 362.

75. Commenting on the need for a new U.S. approach, former Secretaries of State Kissinger and Vance recently wrote:

> We consider it essential that the dialogue with Japan be lifted to a more comprehensive level. Japan will be one of the major powers of the 21st century. We are becoming more and more interdependent. The issue is how to deal with the consequences of interdependency, not how to reverse or change the relationship.

Kissinger & Vance, *Bipartisan Objectives of American Foreign Policy*, 66 FOREIGN AFF. 913 (1988).

trade problem, economic coordination, and burden sharing.[76]

1. A New Approach to the Trade Dispute

Advocates of a full-fledged free trade agreement with Japan rightly have identified the major problem with the current United States strategy. As Ambassador Mansfield stated it, the current approach of "nickeling and diming" Japan to death has created more problems than it has solved.[77] But a free trade agreement on the Canada model may not be the best approach in the case of Japan. Given the subtlety and pervasiveness of the trade barriers that American exporters encounter in Japan, a free trade agreement is unlikely to best serve the United States' interests. The immediate goal should be an agreement that expands trade and addresses our major economic problems. After such an arrangement has been in place for a number of years, a more traditional free trade agreement would be far easier to achieve.

2. Macroeconomic Coordination

Instead of focusing on trade barriers and tariffs, an agreement with Japan should focus on overall trade flows. The United States and Japan need a macroeconomic coordination agreement that uses trade flows as an indicator, rather than a trade agreement in the traditional sense. Both nations should set trade flow targets that demand both increased trade and control of trade imbalances. The targets could use either worldwide or bilateral trade flows and balances as the basic benchmark. The targets should provide that a minimum fixed percentage of exports to Japan be high technology and manufactured goods. This approach is appropriate because these products are at the heart of the U.S.-Japan trade problem and Japan has been least willing to import these products.

The agreement should obligate both nations to use macroeconomic policy to meet the targets. Since the agreement's focus is on expanding trade, it should discourage, if not forbid altogether, trade-limiting policy tools such as voluntary restraint agreements. Such an approach to the trade deficit problem is far more direct than the current ad hoc, bilateral negotiations or the GATT. It recognizes the urgency of the trade problem and directly addresses the trade imbalance, yet it does not force Japan to restructure its economy to American specifications.

The recent devaluation of the dollar and our experience with the G-5 demonstrate the potential for successful macroeconomic coordination. Both governments can greatly change trade flow patterns by controlling exchange rates and relative rates of growth.[78] Moreover, as the Japa-

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76. *See* Baucus, *supra* note 72.

77. *Cited in* Preeg, *Next a Free Trade Pact With Japan?*, Wall St. J., Aug. 12, 1988, at 12, col. 4.

78. *See* J. WILLIAMSON & M. MILLER, TARGETS AND INDICATORS: A BLUEPRINT FOR THE INTERNATIONAL COORDINATION OF ECONOMIC POLICY (1987); S. MARRIS, DEFICITS AND THE DOLLAR REVISITED (1987). For a definition of G-5, see *infra* note 112.

nese economic miracle demonstrates, government programs to encourage trade on the individual business level can have tremendous long-term impact.

The pressure to meet the trade targets would be beneficial to both economies. The targets would encourage Japan to make progress on some of its more fundamental problems. If Japan commits itself to meeting the targets, reform of the distribution system or increasing consumer demand likely would be more attractive options than permanently keeping the yen high or engaging in deficit spending. Japan, nevertheless, would have the flexibility of meeting the targets with the economic tools of its choice instead of having the United States dictate guidelines. The opportunities that open as a result of such an agreement also would encourage American businesses and the federal government to become more export oriented.

In addition to the targets, the United States and Japan should attempt to resolve some of their most persistent trade problems, such as the problem of recidivist dumping[79] and the low penetration of LDC exports into the Japanese market.[80] Both nations should agree to closer policing of recidivist dumpers, and Japan should assent to an LDC import preference similar to the Caribbean Basin Initiative or take other steps to encourage LDC imports. A new dispute settlement mechanism—perhaps modelled on the general dispute settlement mechanism of the FTA—should be established to apply the agreed upon rules and address future disputes in a structured forum.

3. *A Kind of G-2*

One of the most useful functions that such a bilateral agreement could serve would be establishing a framework for closer economic coordination between the United States and Japan—a kind of G-2.[81] As the world's two largest economies, the United States and Japan are in a strong position to exercise leadership in the world economy. As C. Fred Bergsten, the Director of the International Institute of Economics recently wrote: "[T]here is a strong rationale for constructing a G-2 and using it as the primary if informal tool for seeking to exercise leadership of the world economy."[82]

As part of a broad economic accord, a G-2 arrangement could allow the United States and Japan to address two fundamental economic problems: fluctuating exchange rates and uneven world growth. The two countries could establish exchange rate target zones to prevent the wild fluctuations in the yen/dollar exchange rate witnessed over the last

79. C. PRESTOWITZ, *supra* note 17, at 38. Dumping is defined as the practice of selling below cost or below the price at home in foreign markets. Recidivist dumping is the habitual practice of dumping goods on foreign markets.

80. Robinson, *supra* note 64 ("Currently, the United States absorbs 65 percent of [LCD] imports while Japan takes only 7 percent.").

81. The term G-2 is used in Bergsten, *supra* note 47, at 789.

82. *Id.* at 791-92.

decade. Such a step could prevent exchange rate distortions from affecting trade imbalances. The two nations also could coordinate economic policies to ensure that they do not repeat the mistakes of the mid-1980s. The Reagan Administration took the first step toward such an arrangement in the Baker-Miyazawa Accord of 1986 which provided for considerable economic coordination between the United States and Japan.[83] A fully functioning G-2 would likely have kept the U.S.-Japan trade imbalance from reaching its current crisis proportions and would have allowed both economies healthier, managed growth.

A G-2 could lead the rest of the world by example and necessity into further multilateral economic coordination. Certainly, involving other nations in economic coordination would increase its effectiveness. From a practical viewpoint, however, the logistical problems of accommodating the trade agendas of many nations slow results and weaken the mechanism. It is the old principle of too many cooks spoiling the broth. The formulation used in the Baker-Miyazawa Accord for inviting other nations to participate in such an arrangement after it has been established has merit.[84] As a practical matter, once a U.S.-Japan G-2 begins to function, other nations would face the choice of joining the process or allowing the United States and Japan to dictate world economic conditions. As long as the United States and Japan make it clear that they will not allow new members to bog down either decision-making or implementation, wider participation would result in a more efficiently managed world economy.

4. Burden Sharing

The final prong of the U.S.-Japan Accord should address the problem of burden sharing. Perhaps the most vexing aspect of the U.S.-Japan economic equation is the problem of the unequal security burden. The obvious solution to the problem—increasing Japanese military spending—raises serious concerns both inside and outside Japan. Within Japan, the very active peace movement likely will block a Japanese military buildup. Externally, memories of World War II are still too vivid in Korea, the Philippines, and China.[85] Until the United States and Japan address this underlying disparity, however, the United States will remain at a relative economic disadvantage to Japan.

The best approach to this problem is to encourage Japan to increase direct payments to the United States and to increase its foreign assistance, preferably through multilateral agencies. Japan has been

83. *See id.* at 789. The Baker-Miyazawa Accord was an agreement between the United States and Japan to coordinate and bolster both nations' economies. The accord, concluded Oct. 31, 1986 by United States Treasury Secretary James Baker and Japanese Finance Minister Kiichi Miyazawa, required Japan to stimulate its economy and the United States to refrain from attempting to lower the then high value of the dollar. *U.S. and Japan Vow to Cooperate in Economic Moves*, N.Y. Times, Nov. 1, 1986, at 1, col. 6.

84. *See* Bergsten, *supra* note 47, at 792.

85. *See*, Morse, *supra* note 46, at 18.

increasing its supplement to American military spending by assuming a larger portion of the cost of maintaining United States military forces in Japan and the surrounding region.[86] The option of increased Japanese contributions to support American military spending is popular in the United States, but is not likely to be well received in Japan where such payments might be viewed as tribute to the United States. It is, however, one of the most attractive options available. Payments address the unequal defense burden, without raising significant foreign policy problems in East Asia.

Increasing Japanese foreign assistance to make up for low defense spending is likely to be more palatable in Japan. Several prominent Japanese authorities have suggested increased foreign assistance as a way of balancing the security burden without rearming.[87] This idea appears to have taken root; Japan steadily is increasing foreign assistance. According to Prime Minister Takeshita, Japan currently plans to expand foreign assistance significantly in the coming years.[88]

Japan, however, must go even further. For example, as part of an economic accord, Japan might agree to spend some of its current account surplus on foreign assistance to solve the Latin American debt crisis. Such a program would address a significant international economic problem in the process of redistributing the world security burden. Jim Robinson, CEO of American Express, observed that:

> As the free world's second largest economy, and largest creditor, Japan could take the lead by investing in the economic elements of global security. . . . Today's missing element in free world security is the additional economic contribution that Japan and others with chronic balance of payment surpluses might make . . . such an initiative would clearly be in Japan's self interest. It could help dampen anti-Japanese sentiment and protectionism, and would signal that Japan is assuming the leadership role so amply justified by its dynamic energy. Joined and supported by other industrial democracies, the Tokyo plan could become a program as sweeping in its economic benefits and as memorable as the Marshall plan.[89]

E. Benefits of a U.S.-Japan Accord

An accord like the one outlined in this Article is overwhelmingly in the interest of both the United States and Japan. Both nations unquestionably will benefit from a healthier bilateral economic and political relationship. In their analysis of the changing economic relationship between the United States and Japan, many observers believe that Japan increas-

86. *See* Hepstone, *supra* note 70; Romberg, *supra* note 67, at 13; ECONOMIST, *supra* note 67, at 19-20.

87. Romberg, *supra* note 67, at 23.

88. *Significant Increase Slated for Tokyo's Aid Budget,* 1B JAPAN ECONOMIC INSTITUTE REPORT 7 (Jan. 8, 1988).

89. Robinson, *supra* note 64.

ingly has the upper hand in the American-Japanese relationship.[90] This is a superficial assessment of the situation. The reality is that the United States and Japan are increasingly interdependent; each relies upon the other. Japan relies upon the United States as a market for 40% of its exports,[91] and America is the ultimate guarantor of Japanese security. The United States also relies on Japan. It now owes Japan $250 billion and borrows from Japan almost daily to support its budget deficit.[92] Given this tremendous interdependency, a recession in one country likely will drag the other down. In short, both nations have a substantial stake in mutual economic prosperity. An agreement that eliminates some of the fundamental threats to that economic relationship serves the interests of both nations.

Beyond direct economic benefits, a U.S.-Japan accord also provides certain strategic benefits. There is great concern in both nations now about the Europe 1992 project now underway in the EC. Informed observers in both nations fear that a more closely knit internal EC market will result in higher external trade barriers against the rest of the world. Increased European competition could cause hard pressed European businesses to clamor for protection from the United States and Japan.[93] Bilateral talks between the United States and Japan aimed at concluding a sweeping economic accord would be a powerful counter to Europe 1992. If the United States and Japan were moving toward a closer bilateral economic relationship, both would have more leverage to prevent the EC from shutting them out. Continuing negotiations would serve notice to the EC that other nations are capable of closer economic union.

F. Other Bilateral Candidates

The possibilities for new United States bilateral economic and trade agreements do not end with Japan. A number of other nations, including Mexico, Korea, Taiwan, Australia, and New Zealand, are possible candidates for a bilateral trade agreement. The case for Mexico seems particularly compelling. As with Canada, the United States has a long border with Mexico and substantial bilateral trade. The United States has a substantial direct stake in the economic health of Mexico because of the growing illegal immigration problem. Given the economic dispar-

90. *See* Van Wolfren, *The Japan Problem*, 65 FOREIGN AFF. 288 (1986-87) (arguing the U.S. must take measures to stave off serious economic conflict with Japan).

91. E. REISCHAUER, THE UNITED STATES AND JAPAN IN 1986: CAN THE PARTNERSHIP WORK? 10 (1986).

92. *Id.* OTA, *supra* note 3, at 12-13.

93. As Robert Hormatz recently wrote:

> Will European companies that become exposed to greater competition because of lower barriers in Europe try to block lower barriers vis-à-vis the rest of the world to protect themselves from intensified American and Asian competition? . . . there is a risk nonetheless that intra-European deals will be made in important sectors and that regulations will be written to the advantage of European companies at the expense of foreign trading partners.

Hormatz, *A "Fortress Europe" in 1992?*, N.Y. Times, Aug. 22, 1988, at A19.

ities between the United States and Mexico, a U.S.-Mexico bilateral agreement would confront certain problems not raised in the U.S.-Canada FTA. A bilateral trade agreement with Mexico appears to have merit.[94]

Although less work has been done on the other possible bilateral targets, a case can be made for several potential accords. Some of the ASEAN nations have expressed interest in a free trade arrangement with the United States.[95] While there are significant problems with concluding an FTA with a developing nation, particularly a major textile producer, some form of bilateral agreement may be in America's interest. Australia and New Zealand represent another potential trade accord target. The two countries already maintain a bilateral free trade zone.[96] Though the United States would have to address some thorny issues, an agreement modeled after the Canada FTA may be possible with Australia or New Zealand.

III. The Relationship Between Bilateral Agreements and Multilateral Agreements

A. Historical Coexistence of Multilateral and Bilateral Agreements

Though critics of bilateral agreements argue that all bilateral agreements necessarily undermine the GATT, this simply is not the case. From the beginning, the GATT coexisted with various bilateral and plurilateral trade and economic arrangements.[97] The United States is party to several such arrangements, including the U.S.-Israel Free Trade Agreement,[98] the U.S.-Canada Auto Pact,[99] the Caribbean Basin Initiative,[100] and, of course, the U.S.-Canada Free Trade Agreement.

Other nations also maintain extensive bilateral and plurilateral trading arrangements. Two of the most prominent are the EC and ASEAN, but there are others. Sweden, Norway, Iceland, Finland, Austria, and Switzerland make up the European Free Trade Area ("EFTA"), which eliminated all tariffs on industrial products. The EFTA also maintains an industrial free trade area with the EC.[101] Australia and New Zealand

94. *See generally* THE U.S. INTERNATIONAL TRADE COMMISSION, THE IMPACT OF INCREASED U.S.-MEXICO TRADE ON SOUTHWEST BORDER DEVELOPMENT, USITC PUBLICATION No. 1915, Nov., 1986.

95. ASEAN, the Association of South-East Asian Nations, includes Brunei, Indonesia, Malaysia, the Philippines, Singapore and Thailand.

96. *Australia and New Zealand Sign Precedent Setting Free Trade Agreement*, INSIDE U.S. TRADE 3, Aug. 14, 1988.

97. *See* Baker, *supra* note 20, at 38.

98. Israel-United States Free Trade Area Agreement, H.R. Doc. No. 66, 99th Cong., 1st Sess. (1985), *reprinted in* 24 I.L.M. 653.

99. U.S.-Canada Auto Pact, 80 Stat. 271, T.I.A.S. No. 6093 (Jan. 16, 1965).

100. *See* Caribbean Basin Economic Recovery Act of 1983, Pub. L. No. 98-67, 97 Stat. 384 (codified as amended in scattered sections of Titles 19, 26 and 33 of the United States Code).

101. Response by the United States Trade Representative to Questions Posed by Chairman Bentsen of the Senate Finance Committee, *Question 6: Response* (1988) (copy on file at the offices of the *Cornell International Law Journal*).

have a Trade Agreement on Closer Economic Relations ("ANZCERT") which eliminates trade barriers on most goods and recently has been extended to cover some services.[102] In short, special bilateral and plurilateral trading arrangements are extremely common.

B. Preferential Agreements and the GATT

The principle of Most-Favored Nation Treatment for all GATT members is central to the GATT. Nevertheless, there are many exceptions.[103] Article XXIV explicitly allows for the formation of customs unions and free trade zones.[104] The GATT includes this exception because it was recognized from the outset that member nations would want to establish certain preferential trade and economic relationships and that such relationships promote international trade.

The GATT in Article XXIV does place two major requirements on special customs unions. First, they must facilitate trade between the participating states without raising barriers to trade with other nations. Second, they must cover all or substantially all trade.[105] Article XXIV's

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102. *Id.* Other bilateral and plurilateral trading agreements include: Jamaica, Barbados, Trinidad and Tobago, Guyana, Belize, and the Caribbean Commonwealth countries and territories which form the Caribbean Community and Common Market (CARICOM); Costa Rica, Guatemala, El Salvador, and Nicaragua make up the Central American Common Market, Honduras, Panama, and the Dominican Republic have partial membership. Canada maintains a CBI-like arrangement with Caribbean Commonwealth. The EEC maintains a number of preferential relationships with former colonies. There are also a number of other minor arrangements, such as the Latin American Integration Association, the Arab Common Market, South Africa's preferential trading arrangement with several of its neighbors, and Finland's arrangements with Hungary, East Germany, and Czechoslovakia.

103. *Id.*

104. Part III, art. XXIV, § 4 provides in pertinent part:

> The contracting parties recognize the desirability of increasing freedom of trade by the development, through voluntary agreements, of closer integration between the economies of the countries parties to such agreements. They also recognize that the purpose of a customs union or a free-trade area should be to facilitate trade between the constituent territories and not to raise barriers to the trade of other contracting parties with such territories.

GATT, *supra* note 19.

105. Part III, art. XXIV, § 5 provides:

> Accordingly, the provisions of this Agreement shall not prevent, as between the territories of the contracting parties, the formation of a customs union or of a free-trade area or the adoption of an interim agreement necessary for the formation of a customs union or of a free-trade area; *Provided* that:
>
> (a) with respect to a customs union, or an interim agreement leading to the formation of a customs union, the duties and other regulations of commerce imposed at the institution of any such union or interim agreement in respect of trade with contracting parties not parties to such union or agreement shall not on the whole be higher or more restrictive than the general incidence of the duties and regulations of commerce applicable in the constituent territories prior to the formation of such union or the adoption of such interim agreement, as the case may be;
>
> (b) with respect to a free-trade area, or an interim agreement leading to the formation of a free-trade area, the duties and other regulations of commerce maintained in each of the constituent territories and applicable at the forma-

requirement that special customs unions cover all or substantially all trade represents the major legal barrier to future bilateral trade agreements. There is precedent, however, for applying the principle loosely.[106] Most of the major free trade areas, including the U.S.-Israel Free Trade Agreement, the Caribbean Basin Initiative, and very likely the U.S.-Canada FTA, have been or will be reconciled with the GATT through Article XXIV.[107] Parties should structure future agreements creatively so as to conform to Article XXIV. For instance, most developed nations maintain relatively low tariff levels. One way to structure creatively a bilateral agreement that conforms with the "substantially all trade" requirement would be to incorporate an across-the-board tariff cut into any bilateral accord.

Other trade arrangements that do not meet the Article XXIV test (such as the U.S.-Canada Auto Pact and the European Steel and Coal Community) have been reconciled with the GATT through a waiver.[108] There are no formal requirements to obtain a waiver. Any arrangement can be granted a waiver provided that two-thirds of the GATT contracting parties vote in favor of extending it. There is always the possibility that the GATT contracting parties could reject a proposed waiver. In the past, however, powerful nations have been able to obtain the waivers they desire.[109]

In practice, the GATT may not present a significant barrier to future bilaterals. The treaty is limited in scope. Many of the special bilateral arrangements that the United States may wish to conclude deal primarily or exclusively with subjects not covered by the GATT, such as trade in services, investment and exchange rates. Since the GATT is silent on these subjects, any agreement in these areas is beyond its scope.[110] Even the bilateral trade targets suggested herein as part of the bilateral agreement with Japan would not conflict with the GATT. Those targets merely serve as economic indicators for coordinating

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> tion of such free-trade area or the adoption of such interim agreement to the trade of contracting parties not included in such area or not parties to such agreement shall not be higher or more restrictive than the corresponding duties and other regulations of commerce existing in the same constituent territories prior to the formation of the free-trade area, or interim agreement, as the case may be; and
>
> (c) any interim agreement referred to in sub-paragraph (a) and (b) shall include a plan and schedule for the formation of such a customs union or of such a free-trade area within a reasonable length of time.

Id.

106. The Caribbean Basin Initiative provides a good example. The Initiative covers a relatively small volume of the trade between the U.S. and the Caribbean Basin nations, yet it has not been found to conflict with the GATT.

107. *See* Lowenfield, *What the GATT Says (or Does Not Say)*, in BILATERALISM AND MULTILATERALISM IN U.S. TRADE POLICY 59-60 (DIEBOLD ed. 1988).

108. *Id.* at 62-65.

109. Examples include the U.S. waiver to allow import restrictions on agricultural products consistent with Section 22 of the Agriculture Adjustment Assistance Act and the waiver granted for the U.S.-Canada Auto Pact.

110. On waivers, *see generally*, Lowenfield, *supra* nôte 107, at 57-65.

macroeconomic policy; they would not require preferential tariff cuts or other departures from the most favored nation principle.[111] They are no more inconsistent with the GATT, therefore, than economic coordination through the G-5 or the G-7.[112]

C. Bilateralism and Multilateralism are Complementary

Pursuing bilateral agreements actually increases the chances that the United States will be able to achieve its trade objectives in the Uruguay Round. Rather than draining interest from multilateral negotiations, active bilateral negotiations will actually increase other nations' interest in the GATT. Since the Uruguay Round is the only game in town, many U.S. trading partners can now safely drag their feet. If it becomes apparent that the United States is willing to pursue its trade and economic interests bilaterally, however, a new message will be sent. Potential foot-draggers will realize that if they are unwilling to negotiate through the GATT, the United States will conclude bilateral agreements with other trade partners. Thus, active bilateral negotiations increase the cost of stalling in the GATT and improve chances for an eventual GATT agreement.[113]

Judging from the comments of our trading partners, the U.S.-Canada FTA has served the United States well in this regard. Opening negotiations with Japan would send a much stronger message. In other words, bilateral negotiations with Japan are not only an attractive approach to addressing United States economic problems with Japan, but a very good way of reinvigorating the GATT.

Bilateral agreements also can pave the way for expanding the GATT. For instance, the sections of the U.S.-Canada FTA that deal with services and investment demonstrate that an agreement is possible in those areas and provide at least a partial model for a future multilateral

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111. A most favored nation clause, found in most treaties, provides "citizens or subjects of the contracting nations may enjoy the privileges accorded by either party to those of the most favored nation. The general design of such clauses is to establish the principle of equity of international treatment." BLACK'S LAW DICTIONARY 913 (5th ed. 1979).

112. The Group of 5 (G-5) is made up of the United States, Japan, West Germany, Britain, and France. The Group of 7 (G-7) has the same members plus Canada and Italy. Both are informal, ministerial level organizations designed to allow the major economic powers to coordinate economic policy.

113. The Reagan Administration pursued this strategy on a limited scale. As former Treasury Secretary James Baker wrote in reference to the FTA:

> The rewards of this agreement offer an incentive to other agreements. If possible, we hope this follow-up liberalization will occur in the Uruguay Round. If not, we might be willing to explore a 'market liberalization club' approach, through minilateral agreements or a series of bilateral agreements. In this fashion, North America can build steady momentum for more open and efficient markets. [The United States Trade Representative] has reported that there are voices in other nations—including Japan, South Korea, Taiwan, and some of the nations of the ASEAN—that have indicated that they do not wish to be left behind.

Baker, *supra* note 20, at 41.

agreement.[114] A similar case can be made for the treatment of services in the Australia-New Zealand Agreement on Closer Economic Relations.[115] Along the same lines, if the United States and Japan agree to police recidivist dumping more carefully, it would be easier for both nations to later extend this courtesy to the rest of the world; a policing mechanism would be in place and conceptual problems would have been addressed.

By opening markets on a bilateral basis, otherwise insoluble political problems can be attacked incrementally; bilateral agreements might break the political ice for multilateral agreements. Once the first steps have been taken to eliminate a trade barrier or solve an economic problem for one nation, political problems appear less formidable and it is easier to reach similar agreements with other nations. For example, opening the Japanese construction market to the entire world might be extremely difficult politically for Japanese officials. Opening it only to the United States might be somewhat easier. Once the market is opened partially and the Japanese industry and government become accustomed to the new situation, further liberalization will be easier to achieve. Far from derailing the GATT, bilateral agreements can blaze a trail that the GATT can follow.

Bilateral agreements also can provide significant benefits to third parties. For example, a U.S.-Japan initiative that eliminates a large portion of the trade deficit and strengthens the framework for international economic coordination would ease pressure for protectionism within the United States. Moreover, if Japan agreed to further open its markets to the third world or assist in debt relief, the entire world would benefit. Finally, in today's interdependent world economy, healthy economic growth in the world's two largest economies directly benefits the rest of the world. The benefits from eliminating major trade and economic distortions will ripple around the globe.

IV. Strategy For A New President

Dr. Paul Kennedy recently wrote: "To be a great power—by definition, a state capable of holding its own against any other nation—demands a flourishing economic base."[116] The next President should keep this simple statement foremost in his mind as he sets policy priorities.

Given the gravity of the international economic problems that the United States now faces, the next President must put trade and international economic policy much higher on his agenda than past Presidents.

The world is changing; American wealth is increasingly dependent on international economic policy. As the mounting trade deficit and

114. *See id.* at 40. *See also* Schott, *Implications for the Uruguay Round*, in THE CANADA-U.S. FREE TRADE AGREEMENT: THE GLOBAL IMPACT 159-72 (J. Schott & M. Smith ed. 1988).

115. INSIDE U.S. TRADE, *supra* note 96, at 3.

116. *See* P. KENNEDY, THE RISE AND FALL OF THE GREAT POWERS 539 (1987).

national debt demonstrate, the United States is no longer the world's preeminent economic power. The gap between the United States economy and the economies of other major economic powers is closing rapidly.

For the most part, past Presidents have let trade and international economic policy take care of itself. These complex subjects lacked the instant appeal of defense policy or arms control. The American economy and its businesses were strong enough to muddle through on their own. For many years, the President was the only national leader to attend international summits without his trade minister. The rest of the world understood the message—America had other priorities.

Since there was little interest at the top, the formulation and execution of United States trade and international economic policy generally has fallen to a few academic-oriented thinkers. There was and has been a tendency among this group to put the GATT at the center of United States trade policy. While the GATT does have considerable theoretical appeal, it cannot be the United States' only tool. The United States must be willing to pursue its international economic interests through bilateral and plurilateral agreements as well as through the GATT. The United States no longer can afford an exclusively multilateral approach; it can no longer rely on the old ways of doing things. Times have changed, and American strategy must also change.

The new President should adopt a flexible posture. He should increase significantly the resources devoted to international trade negotiations. He should continue a strong effort in the Uruguay round. But this alone is not enough. The President also should identify those nations that are attractive targets for new bilateral or plurilateral agreements and begin negotiations. The United States then should shift resources to whichever of the two efforts demonstrates the most progress.

If the United States makes it clear that it will pursue vigorously the front where progress is forthcoming, it will send a message to the world that it is serious about achieving its international economic objectives. Perhaps the threat of bilateral agreements will serve as a catalyst to real progress in the GATT round. Aside from the potential for positive impact on the GATT, however, new bilateral agreements are desirable in their own right. They should be treated as such; to proceed on any other basis is to remain trapped in the GATT-first mindset.

V. Conclusion

If the new President continues the United States' historic pattern in trade negotiations, America is not likely to achieve its objectives in the GATT. But if the next President establishes a two-front strategy that emphasizes bilateral and plurilateral agreements as well as the GATT, the chances for success on both fronts greatly increase. In four years, the President may have concrete results to show for his efforts, instead of a vague commitment to the GATT process.

It has become fashionable to speak about the decline of America. But the lesson of United States economic retrenchment is not that America must become a second rate world power. Rather, the lesson is that the United States must look for new ways of approaching trade. To again quote Dr. Kennedy:

> In all the discussions about the erosion of American leadership, it needs to be repeated again and again that the decline referred to is relative, not absolute, and is therefore perfectly natural, and that the only serious threat to the real interests of the United States can come from a failure to adjust sensibly to the newer world order.[117]

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117. *Id.* at 534.